

General Information Letter: Special allocation rules for income received from an investment partnership do not apply to tax years ending prior to July 30, 2004.

July 31, 2006

Dear:

This is in response to your letter dated July 19, 2006, which has been forwarded to me for review. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

In your letter you have stated the following:

The taxpayer has asked us to respond to your BTR-45-B Nonfiler Notice dated July 11, 2006 for tax year ending December 2003. The taxpayer is not required to file an Illinois Business Income and/or replacement tax return for the 2003 tax year because the taxpayer conducts no business activity within the State of Illinois, and the taxpayer does not derive business income from any partnership investments in Illinois.

Your notice indicates that the taxpayer is an investor in FUND, LP (FEIN XX-XXXXXXX). The FUND, LP does have a mailing address in CITY, Illinois. However, FUND derives income solely from interest, dividends, foreign currency transactions, and short term and long term capital gains. In addition, the Fund incurred investment interest expense as well as other investment expenses. The instructions for Schedule NR for IL-1040 provide that "business income is income you earned or received from any activity that you took part in during the regular course of your trade or business." IRS regulations and rulings have made it clear that the activity of investing is generally not considered to constitute a trade or business activity. Therefore, the interest, dividend and capital gains generated by the FUND cannot be considered business income allocable to the state of Illinois. Since no business activity is conducted within the State of Illinois, the taxpayer is not required to file an Illinois income tax return for the 2003 tax year.

Response

Section 305(a) of the Illinois Income Tax Act (35 ILCS 5/305) provides:

The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

For taxable years ending on or after July 30, 2004 (the effective date of Public Act 93-0840), this provision has no application to partners in an "investment partnership," as defined in Section 1501(a)(11.5) of the Illinois Income Tax Act (35 ILCS 5/1501), because the income of an investment

partnership is treated as nonbusiness income by the partnership. However, for taxable years of the investment partnership ending prior to July 30, 2004, the investment income of an investment partnership is the partnership's business income. See, for example, Administrative Hearing Decision IT-95-3 (1995). Pursuant to Section 304(a) of the Illinois Income Tax Act (35 ILCS 5/304), an investment partnership that derives no business income from sources outside the Illinois would treat all of its income as business income allocable to Illinois, and, under Section 305(a), each nonresident partner would allocate all of its partnership share in that income to Illinois. Accordingly, a partner in an investment partnership conducting operations within Illinois is very likely subject to Illinois income tax for taxable years of the partnership ending prior to July 30, 2004.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax